DOW THEORY LETTERS INC.

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June 4, DJIA 963.90; PTI 572; A-D ratio -24.79
June 11, DJIA 978.80; PTI 576; A-D ratio -24.45

ON MY MIND: In the 30 years since the mid-1940's that I've studied the stock market, I've seen advisors come and I've seen them go, maybe a hundred of them. I've never seen an investment service based on telling people "what stocks to buy and sell, and when" stay in business. The reason why a "buy this today, sell that tomorrow" service doesn't stay in business for long is that their record over a period of years is never worth a damn. I've known individual investors, many of them, who have made money in the market over the years by buying values at roughly the right time and selling at roughly the right time. But services that tell you and your banker and your grandmother to buy General Motors here at 67 and sell it next year at 80, they just don't last. They don't last because they're offering people a pipe-dream. The fact is that each man has to learn and develop his own way of operating in the stock market. What works for you will not work for your neighbor, because your neighbor doesn't think or act the way you do.

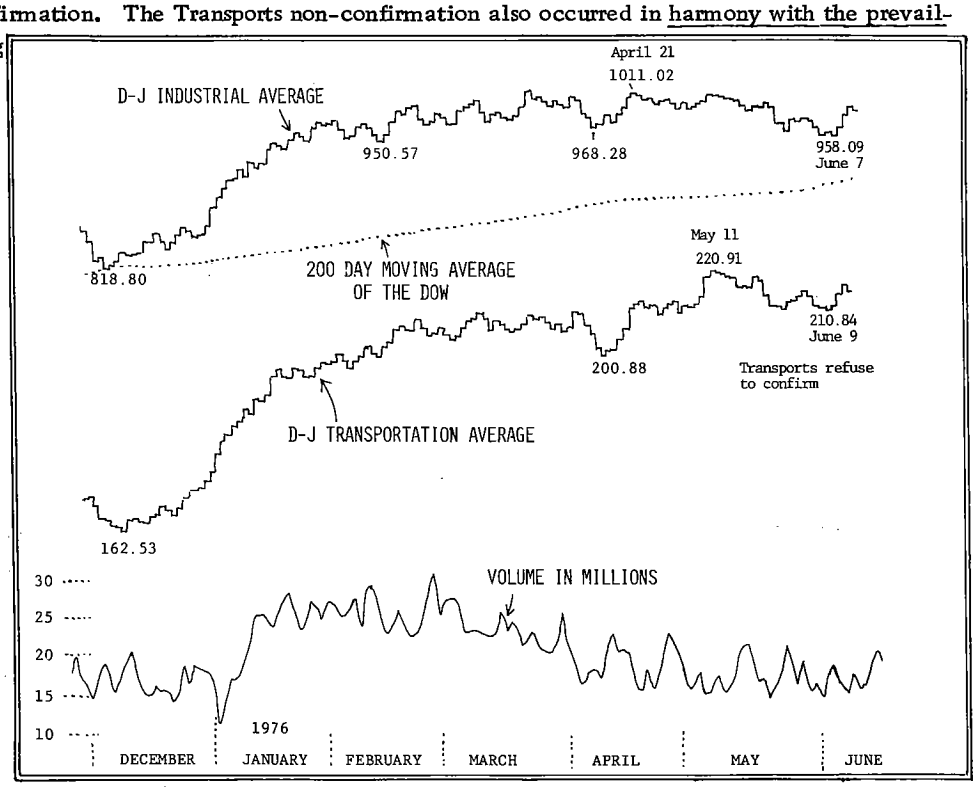
I've always tried to give subscribers the benefit (and hopefully there is a benefit) of what's on my mind. Much of this particular report concerns itself with something I've been thinking about and worrying about for some time, and that's the need for diversification based on the current trend of political, social and economic events. At any rate, Letter #667 spends a lot of time on this matter, and I hope you find it worthwhile.

THE MARKET: First things first, and of course the first thing we have to deal with is the stock market itself. I've been saying for some time that the overriding technical consideration in this primary bull market is the fact that the D-J Transportation Average would not confirm the weakness of the Industrial Average. While Wall Street was reaching a consensus that "the Dow was going to 880-900," the Transports were trying to tell those of us who would listen a quite different story.

Please refer to the page 1 chart of the Averages. Note that the Industrials and Transports recorded mid-April lows of 968.28 and 200.88 respectively. Following the April lows, Industrials rallied to a bull market high of 1011.02 (April 21), while Transports continued on to a high of 220.91 (May 11). The market then turned weak. On May 27, Industrials broke under their 968.28 April low to close at 965.57. A minor rally materialized, followed by new weakness. On June 9, Industrials slid further, to close at 958.09.

Now study the Transports. Note that the May weakness took the carriers down to 211.35 on May 27. Then (on very low volume) Transports sank to a June 9 low of 210.84. Thus, the Transports at their weakest point held 10 points above their April 9 low of 200.88.

This was an outstanding downside non-confirmation. The Transports non-confirmation also occurred in harmony with the prevailing primary bull trend. I have been saying that a persistent refusal by Transports to confirm the Industrials low would throw the burden of proof (of market weakness) on the bears. That is exactly what happened. On June 10 the entire market began lifting off its lows. As suddenly as selling pressure evaporated, a new wave of buying swept over Wall Street.



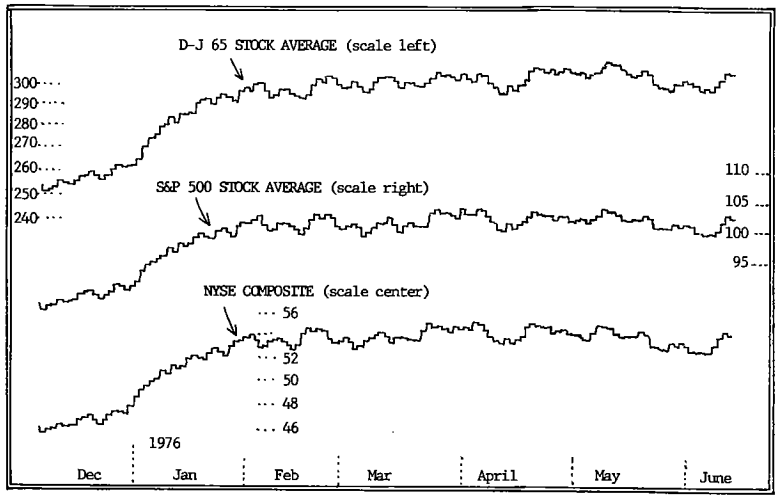
It is worth noting that volume during a primary bull market deserves a different interpretation than volume in a bear market. Thus, dull, low-volume areas in a bull market usually denote a drying up of selling pressure, and such conditions often identify a buy-spot. But dull-volume areas in a primary bear market can imply a falling away of buying power, and these areas are often ideal spots for shorting.

At any rate, it is significant that the volume during late-May and June dropped to low levels, at a time when (1) the

Industrial Average was recording its unconfirmed lows, and (2) when selling pressure "could have been" rising, but did not. The fact is that volume at the recent May-June low was about half of what it was during the January-February buying stampede. I took the contraction of volume during the May-June retreat as a sign of internal strength (and a sign of general unwillingness on the part of investment interest to distribute their shares).

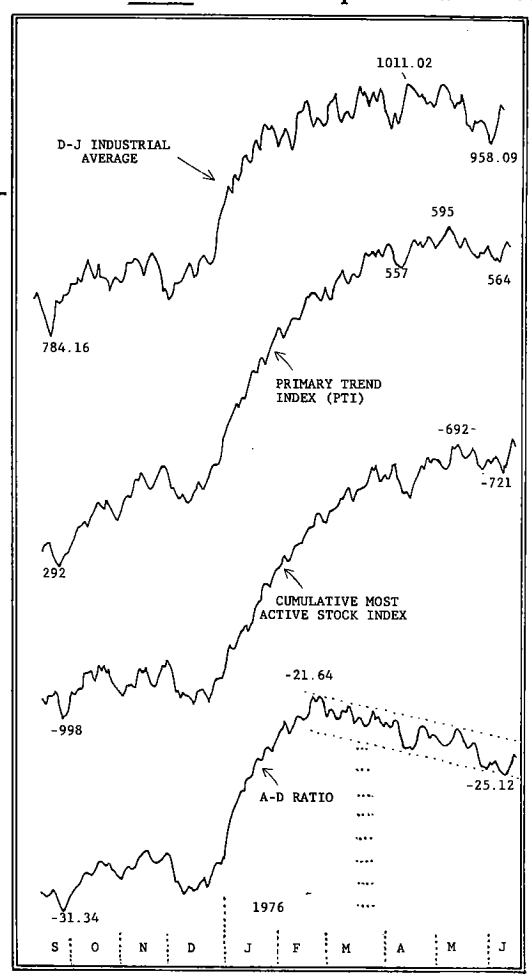
Conclusion: The primary trend has been bullish since late-1974, and it remains bullish. The secondary trend will remain bullish as long as one or both Averages hold above their most recent important lows, 200.88 for Transports (April 9) and 958.09 for Industrials (June 9).

Whether the market is ready for a direct assault on the 1976 highs (at this time) remains to be seen. But with the secondary trend now visibly bullish, it will pay us to keep one market eye trained on the 1976 bull highs. Those highs are the 1011.02 Industrials peak of April 21, and the 220.91 Transports high of May 11. A bettering of both of those highs would obviously reconfirm the primary bull trend.



Further Comments: I have stressed the constructive action of the various Composite Averages throughout 1976. As you can see on the chart, these Composites never did break down during the February to May weakness, and the remarkable fact is that all three of these broad Averages are currently closing in on their 1976 bull market highs. The three Composites showed remarkable resistance on the downside, and they appear to want to move up strongly when the market rallies. My own feeling is that if they do break out on the upside, the market could be on its way to a sustained and surprisingly strong bull swing. Such action, I believe, would come as a shocker both to Wall Street and the public.

Next, let's turn to those three indicators which (to my mind) have told us so much about the underlying technical condition of the market. First (refer to chart) we have the Primary Trend Index (PTI), which is my amalgam of eight critical market averages and indicators. As noted in the last Letter, the PTI has been acting well throughout this correction. Following the 1976 high of 595 (May 10), the PTI sank to a June 9 low of 564. But the June 9 low was above the earlier April 12 low of 557. Thus, the trend of the PTI remains bullish, and it is currently within 8 points of its peak! The PTI never really turned bearish in 1976, and this action has been a strong influence on my own constructive thinking.

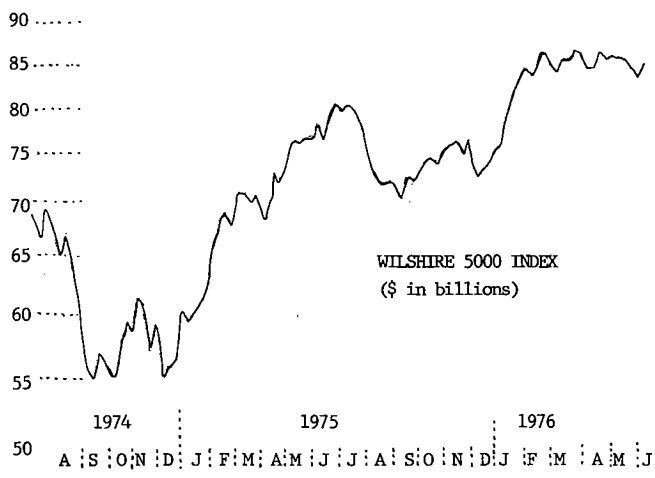


The Cumulative Most Active Stock Index (CMAS) is, in effect, an advance-decline line of the daily 15 most active stocks on the NYSE. The market will usually follow a persistent trend in this index. The CMAS has been even stronger than the PTI during 1976, but the two indicators together have been consistent in pointing to underlying strength ever since January (of course, you must add the Transportation Average to the list of the "mighty three.")

I think that it is extremely significant that on June 14 the CMAS jumped to minus 690, a new high for 1976. This is real bull market action, and it implies that in due time the rest of the indicators and Averages will follow. CMAS actually traces "big money" accumulation or distribution, and I read the new high of June 14 as continuing bull market accumulation.

Finally, we have the A-D ratio, showing the advancing or declining tendency of all NYSE issues. It is significant that in all the downside action from February 24 to early June, the A-D ratio lost only 3.48 points following the 8.77 point gain of December to February. We have therefore been witnessing a long, shallow correction. I have drawn the correction in the form of a descending channel. My guess is that if and when the A-D breaks above the upper channel line (and we are very close), the weakness in breadth will be over.

HIGH-LOWS: The trend of new highs and lows on the NYSE is usually a lag statistic. Nevertheless, I note that the low for the differentials (weekly new highs minus lows) occurred two weeks ago on the week ending May 28 at minus 117. Barron's will probably show a plus this week (more highs than lows). Even more important, M/G Financial keeps a running tabulation of the weekly new highs and lows for the past 52 weeks (it's moved up each week). This high-low index never turned minus and the low was plus 32 on the week ending May 24. I think it's significant the M/G Financial listings never turned negative during all of 1976's weakness.



BULL MARKETS GENERATE ASSETS: When the primary trend of the market turns bullish, we have both a prediction of better things to come plus a phenomenon which we might term a self-fulfilling prophecy. To illustrate this concept, I have included my chart of the Wilshire 5000 Equity Index. This is an index which shows the dollar value (in billions) of all the stocks on the NYSE and the AMEX plus all those stocks actively traded in the over-the-counter market.

Note on the chart that at the 1974 lows, the total market values amounted to about $550 billion dollars. At this point the primary trend turned up, confirmed by a Dow Theory bull market signal on January 27, 1975. By June, 1975, the Wilshire Index had climbed to over $800 billion, a total increase of $250 billion. During the 1975 reaction the value of stocks dropped $100 billion, but by early 1976 the Wilshire Index had advanced to $867 billion. Thus, in a period of a year and a half the total value of US stocks had risen over $300 billion or about 58%. That represents a fantastic increase in values in the portfolios of individuals, institutions, and private corporations. Add to this the tremendous increase in bond values and you have a massive rise in the wealth of America.

When wealth is "created" through rising values, it permeates society. Everyone feels richer, happier, more optimistic—and more prone to spend and invest. This is the fuel through which a primary bull market grows. Ultimately, of course, the rising enthusiasm gives way to euphoria, misplaced optimism and finally disillusionment. And disillusionment (reality) sets the stage for the next bear market.

TO SURVIVE: I am receiving a steady flow of mail all oriented towards one overriding question, "What happens after this bull market dies? What do we do to survive in a world where the free enterprise values are changing or disappearing, in a world where capitalism may be rotting away?"

I could hold off on this question for a year or so (perhaps longer). I could say, "Well, these worriers are still in a state of shock from the 1973-74 market collapse, and the fact that this is a bull market has not even entered their consciousness. But despite my current optimistic beliefs based on the prevailing primary bull trend, I do find myself looking ahead — and wondering. So I might as well devote a Letter to some of the relentless problems which I see coming up for you, me and the nation.

First, I feel that we are indeed moving towards a climax, one which may strike within the next five years. History suggests that when the prevailing economic structure totters, there is a subsequent broad swing either to the left or the right. Frankly, I don't know which way the ultimate major swing will go. On the one hand, the US has a strong background of economic conservatism, and that is much more easily seen if you live in the Western US rather than in the East. Americans harbor a deep suspicion of centralized power, Government interference, Governmental power, and politicians in general. Americans tend to be "do it yourselfers." All this militates towards an ultimate swing back to economic conservatism. Conservatism could come via "a strong man," the proverbial "man on the white horse." An all-powerful figure (a man, for instance, like France's deGaulle) would be against American tradition, but times are changing and a swing away from liberalism is certainly one possibility.

On the other hand, the actual trend has been towards big government, and this trend could move towards its logical conclusion. Today's big government has been a virtual octopus, reaching out into every crack and crevice in the nation. Regulations that would have been considered unthinkable 20 years ago are now accepted without protest. In the event of an economic breakdown, who is to say that the US Government would not simply announce "a state of emergency" and then assume total power. With government employees now a huge portion of the voting population, with the rest of the civilian population feeling increasingly impotent, there is a good possibility that capitalism could be legislated out of existence. The new leaders would term capitalism "unworkable, incapable of taking care of its citizens." And, of course, the thesis that Government is supposed to take care of all of us is not even questioned by most people today.

At any rate, these are the two possibilities that I see growing out of the current trends. If Carter and the Democratic Party take over in 1977 (and there is an excellent chance that they will), then the whole process could be accelerated. Carter's lead economist (Klein) has already stated that the Carter Administration's first concern would be to bring unemployment down. That probably tells us all we need to know about Carter's economics. They 're going to be Government centered; they're going to be expensive.

What do we do in preparation for either of the two above-outlined scenerios? My own thinking has changed considerably over the past few years regarding survival in this debt-choked world. The greatest change in my thinking has to do with certainty. What I foresee in the future could be a totally new experience for American investors. No longer will the problem be one of simply picking a batch of Aaa - rated bonds or a selection of Treasury bills and sitting out the coming storm on Wall Street and in the economy. In the next bear market there is a good chance that the currency itself could go, that gold would be confiscated again, that a multitude of tax-exempt features in investments would be altered, that bankruptcies would be rampant, that many law enforcement agencies would at least temporarily shut down (due to lack of funds).

 What does this mean for the investor (or should I say survivor)? It means that one should be prepared to lose a certain portion of his assets. There is no question in my mind, certain investment areas are going to be "totaled" in the next major downturn. And this means that one has to give up the idea of the truly safe area, the "guaranteed survival vehicle."

That leaves us with no other choice but the concept of diversification. For this reason I would like all my subscribers to start thinking (and acting) in terms of a program of diversification——now. How, what, where to start, these are some of the obvious questions. And here is a partial list of areas that I feel are vital.

(1) I believe that a house (cooperatives and condominiums do not interest me) which is debt free is probably the best place to start. I realize that this is difficult if not impossible for many subscribers, but that doesn't change my mind as to the desirability of a debt-free home.

(2) Farm land is fine if you are a farmer, but I have many doubts about holding a lot of land unless you mean to improve it—and fast. With rising taxes, with the prices of non-residential type land not rising and actually declining in many cases, with the illiquidity of land (it is hard to sell in a hurry), I do not feel that holding land where you do not live is a satisfactory part of a survival program. If you have a few acres in Connecticut or California, and you live on that land, fine. If you live in NYC or Chicago, and you think five acres in New Mexico or Florida are going to help you in an economic collapse, I say forget it.

(3) Some of your assets should be in real money, and that means gold. I would suggest around 5% or even up to 10% in modern gold coins such as coronas or krugerrands (right now, coronas are the best buy, selling for less than 3% premium over actual gold value).

(4) Some percentage of assets (10% to up to 20% or more, depending on your expertise and disposition) should be in "things" of obvious and indisputable value, such as good 19th Century US postage stamps, works of art, antiques, paintings, etc.

(5) The rest or the negotiable part of your assets can be placed in stocks, bonds (tax-exempts if you are in a high bracket), but since most of these Letters deal with this area, there is no point in going further into the "how" of investing in this piece.

(6) I want to say a word about investments, annuities, holdings in foreign countries. Many of you may consider such ventures just another avenue of diversification. Personally, the foreign investment interests me less and less. I take an increasingly dim view of Europe (and even Switzerland) as a haven for money. If Italy goes Communist, perhaps followed in time by France, all of Europe will be shaky, and Switzerland will look like an island in a storm. Much of the "tax haven" money sent by Americans to foreign lands is simply tax-evasion money, and I most definitely do not advocate illegal actions. Another thing to consider is that the bank secrecy wall is being slowly chipped away by large, tax-hungry governments such as the US.

Aside from the hoped-for avoidance of taxes, the only reason for assets in foreign lands is protection against an ultimate US grabbing of one's property. But I am increasingly skeptical of this line of thinking. If we reach the point where Uncle Sam is willy-nilly grabbing assets, then most of the rest of the world will be confiscating too. And if times get that rough, we can be sure that exchange controls will be instituted. That means that you won't be able to get your money out of a Swiss or Dutch bank; it will be "frozen." So much for foreign "safety."

At this time I might as well go into one other popular fantasy. It is that you can somehow beat the Government out of taxes if your money is in Bermuda or the Cayman Islands. Here are the facts. The US Government holds that if you live in the US or you are a citizen of the US, then you pay the US Government taxes. And they don't care where you earn the money. You can raise cattle in Brazil or sell diamonds in Hanoi, but the US Government says pay the taxes. You pay the taxes when you make the money, not when you bring the money back, and not when you convert the money to dollars or anything else.

Ponder that one, and you'll realize that a lot of Americans who are fooling with investments in foreign lands are monkeying around with tax evasion, not tax avoidance. Tax evasion is illegal, while tax avoidance is fine. If it's legal, and it brings your taxes down, that's avoidance, and the Government says that if you can legally reduce your taxes, go ahead. (I want to thank Harry Browne for some of the above paragraph. His latest report goes into the subject in detail. His report is out of Box 5586, August, TX 78763).

SOVIETS & GOLD: As long as I'm talking about the future, I want to include this piece on the external danger to the US, and the free enterprise system. It has to do with Russia, but it does not have to do with war. You guessed it, it is about the Soviets and economics. Perhaps one day some Russian writer will pen a book entitled, "How We Won The World With The Help of American Stupidity."

At any rate, in the June 7 issue of The Money Manager, there appears a most interesting article by Mr. Gabriele Kerekes, a VP at Josephthal & Co. Here, in essence, is what the article states, and I frankly thought it interesting enough to include in this report:

(1) Russia wants to dominate the world. But Russia has given up on any new military conquests; the probability of nuclear warfare makes military action far too dangerous.

(2) Russia realizes that it is impossible for her to hold the entire Communist world (and all her satellites) under tight military domination. But economic domination and economic dependence is feasible. The economic concept would explain the great current Russian emphasis on naval forces (which can move rapidly to any part of the globe).

(3) In order to dominate the world economically, the Russian plan entails: (a) forcing and promoting inefficiencies and stupidities on the part of the Free World, and (b) building the Russian currency (ruble) to the point where it's the "wanted" money, the

convertible money, and the reserve currency of the world.

(4) In order to bring about the world "ruble domination," it will be necessary to discredit all of Russia's competitors, particularly the advanced capitalistic nations of Europe plus the US and Japan. So far, these countries have done a beautiful job of fitting into the Russian master strategy. They have done this via their floating currencies, their astronomical military spending, their huge and growing national deficits, and their continuing policies of downgrading gold as the core of their monetary systems.

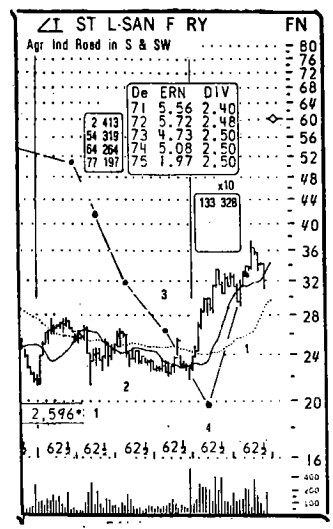
(5) Undoubtedly the greatest plus for Russia is the West's policy of planned inflation with its accompanying underming of the people's faith in their respective currencies. This steady deterioration in paper currency is now being augmented by the IMF and its periodic gold sales. The gold sales are allowing Russian agents to pick up large quantities of gold.

(6) The soviet master plan entails Russia gaining control of the major part of the world's gold. Once having gained control, Russia will raise the price of gold to $500 an ounce or more, make the ruble convertible, and thereby create the most wanted currency in world trade. This will be a process not too different from the one followed by England during the era of her great power (the 19th Century).

(7) In order to carry out her plans, Russia will have to either control South Africa or work out a deal with her in which S. African gold production will be tied up. If she can accomplish this, Russia will own most of the world's gold, and she will control the production of the rest. Along these lines, it is interesting to note that the only aggressive act to come out of Russia in recent years was the pressure placed on S. Africa via Angola (carried out by the Cubans). That act represented the Russian "stick" being waved over S. Africa. If the stick fails, there is a "carrot." The carrot would be the chance of a Russian-S.African gold cartel. With S. Africa's position becoming increasingly difficult, who is to say that she would not "work" with Russia, with say $500 or $800 gold as the enticement!

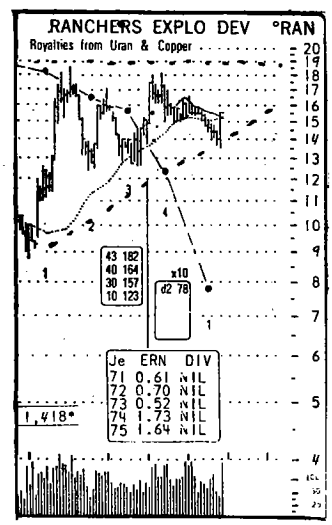
Does that script sound impossible, ridiculous, frightening, outlandish? I did not think it sounded far-fetched when I wrote about it over a year ago, and I think it sounds even less absurd today. In my humble opinion, history may date the decline of the West with the concerted recent and current attempts to downgrade gold (indeed, to phase it out of the monetary system). The history of the world going back to Biblical times can be traced by the path of (and accumulation of) gold. In view of that, can anyone wonder what the verdict of history may be regarding the period of the 1960's and '70's in the Free World?

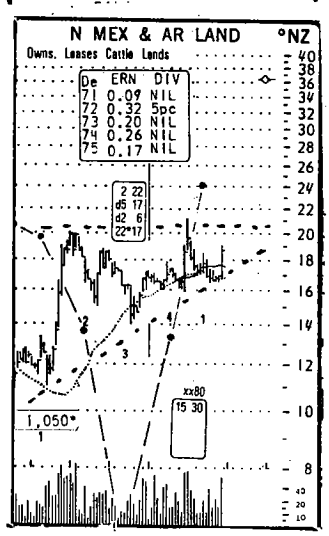
STOCKS: With Californians voting down the anti-nuclear initiative, it looks as if the way is clearing for the age of nuclear power. Currently, there is a scramble on (on the part of power users) to tie up or connect with uranium producers. The current (early) speculation in uranium producers in this non-speculative juncture of the market suggests the possibility of later important advances in uranium stocks.



At worst, the stocks of uranium producers represent reasonable asset plays, and I want to mention three stocks which look interesting to me (chart courtesy of Quote, PO Box 213, Wichita, KA 67201). The first is New Mexico & Arizona Land listed on the AMEX. NZ has a joint venture with Western Nuclear which is working a good uranium deposit. The company already has contracts with four utilities to deliver uranium starting in 1978. The company also explores for oil and gas with partners, Amoco, Cities Service and Shell and others. NZ is clearly a land-asset play, and the company is aggressive and moving into many areas. Selling around 19, NZ has only 1 million common shares outstanding, of which half are owned by a rail company — so if you buy this stock, buy with care, and patience.

Next comes St. Louis-San Francisco, a NYSE number, a good rail system serving the Southwest and South. At 37 it yields 6.7% on its 2.50 dividend. Revenues and earnings are up sharply in 1976. But the "kicker" is that FN owns 50.1% of New Mexico & Arizona Land. As a rail, I like FN, as a rail with an interest in NM & Arizona Land I like it especially well.

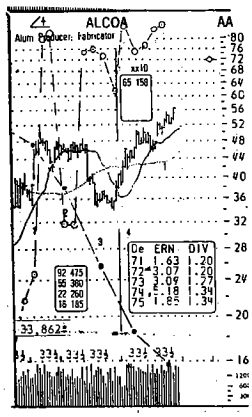


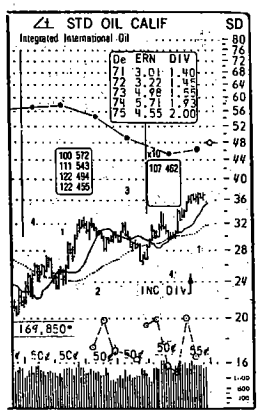


Finally, we have Ranchers Exploration, an AMEX stock in the 16 range. RAN is basically a copper producer, but 6% of its revenues and 22% of its profits come from its uranium operations. RAN is planning a shift towards increasing uranium emphasis, and this should help the stock in due time. RAN is exploring for gold in Alaska along with two other corporate partners. I feel that RAN is an interesting, speculative asset play in the 16 range. RAN, like NZ, is a thin issue with only 1.4 million shares outstanding (24% of which are held by CC Anderson, Sr.).

Note on the charts that I have drawn dotted lines which show that both NZ and RAN are in large ascending triangle patterns. Such patterns usually denote areas of accumulations, since they are

composed of a series of rising bottoms and flat tops. The meaning here is that buyers are picking up the stocks at successively higher prices, but they halt their buying at the top areas (or 19 for RAN and 20 for NZ). The upside breakout will come when the stocks push aggressively above the top or flat areas of the ascending triangles.

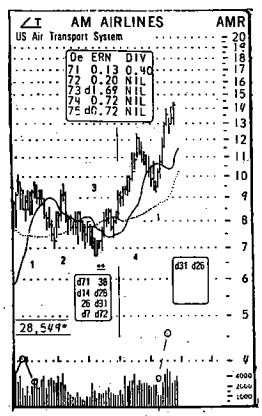




Among the Dow stocks, in the Industrial section Standard of California and Alcoa are acting well and look particularly strong to me. In the carrier section, I like American Airlines (and the relative strength of the Air Transport group is still heading up after the three-year collapse of RS which began in mid-'72 and ended in mid-'75). The charts show the action in these three issues.

CORRECTION: E. F. Hutton was left out of the La Jolla listings at the end of the last Letter, as was Stone & Youngberg. Latest count is eleven brokerage houses in La Jolla, and I guess that should hold us for a while.

Speaking of La Jolla, this town is totally daffy about German autos. There are so many Mercedes here that a friend of mine said he woke up one morning, looked out the window and could have sworn he was in Dusseldorf. After riding BMW motorcycles for 14 years, I recently decided to try one of their four-wheelers. I want to state here and now that in my humble opinion, the little BMW 2002 is the best car value, dollar for dollar, on the road. The word is getting around, and the dealers in this area are selling BMW's as fast as they can get 'em.



SUBSCRIBERS who have price charts or statistics on valuable items such as farm land, residential houses, groups of US postage stamps, categories of antiques, guns, diamonds, etc., I would greatly appreciate copies of what you have. I want to run a composite chart of various items, and I feel that such a chart would prove extremely useful to all of us. I'm sure that among my subscribers I have experts on every field from pearls to Picasso, from silver to stamps. Categories I am particularly interested in are farm land, residential homes, diamonds, antiques, coins, US postage stamps, autographs, Americana, art.

LATE MARKET NOTES: The character of the market appears to be changing after almost four months of sideways, consolidating-type meandering. Many of the indicators discussed on page 2 are now nearing their 1976 highs, and I would guess that the broad Composite Averages as shown on page 2 could make a move to the highs. I believe that the more volatile D-J 65 Stock Average (made up of all the stocks in the D-J Industrials, Transports and Utilities) will be the first of the Composites to break out to a new 1976 bull market peak. The high for the D-J 65 was the May 11 peak of 310.12, so watch that figure carefully. I think a bettering of that peak on the D-J 65 would "set off" the whole Wall Street syndrome to the upside.

Remember, this is a primary bull market which has been consolidating, correcting, "holding back" for almost four months (ever since the February 24 peak on the Advance-Decline ratio). When this situation occurs, there is always a certain amount of selling, moving out of positions, building up of bearish (i.e. short) positions, and rising pessimism. That kind of action and sentiment tends to refresh and strengthen a primary bull market.

When the eventual upside breakout occurs, the result is like a trigger being pulled or like a trap being closed. The entire bear element suddenly finds itself on the wrong side of the market, and the upside action then begins in earnest. The action is touched off by the flight of the bears, the switching of many bears to the bull side, the covering of shorts, but most importantly by the pressure of the bulls who find confirmation for their optimism in the action of the market itself. This confirmatory action may be a new high in the Dow Industrials, the Transports, the D-J 65 or some other important Average. Once such confirmation in the form of a new high appears, one can almost feel the surge of the bull forces as buyers come in from all quarters.

Although I obviously can't prove it, I believe that we are near something of this sort now. I will be even more convinced if the PTI or one of the Averages provides the first upside "signal."

POLITICS: It looks as if Eliot Janeway's prediction of a "Democratic landslide" may not be too far off the mark. Carter has taken over the Democratic party like a wind sweeping over the prairie. The rush to get aboard the Carter bandwagon is jamming the doorways. Meanwhile, Mr. Ford's voice (to me) sounds weaker and fuzzier. He lacks spark, flair, and is inarticulate. Carter represents something new, something possibly exciting. And with the latest Congressional scandals, the nation is increasingly ready for anything new. I've never seen the country so disgusted with Washington.

US sentiment has been "in the dumps" for almost three years, and my guess is that it is ready to come out of the dumps, at least for awhile. I believe the market has conceded a Carter victory, and that it has discounted the worst that could come out of a Democratic sweep. The next major move could be Wall Street's discounting of the best from a Carter victory. Out of periods of despondency come periods of elation. The cycle of immorality gives way to the cycle of morality. Like it or not, believe it or not, Carter represents morality to the people, the "man from the soil," the "man close to God." Against that, the man Mr. Nixon chose is going to have one tough fight come November (and in case you're interested, I'm not a Democrat).

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